

Revenue Update
to
Joint Appropriations Committee
January 8, 2008

JLBC

Current Economic Conditions Have Had Widespread Impact on Revenue Collections

- Through December, collections are down (1.7)%.
- General Fund revenues are \$(440) million below forecast.

Year-to-Date	
<u>Category</u>	<u>% Growth</u>
Sales Tax	(0.3)%
Individual Income Tax	(0.8)%
Corporate Income Tax	(15.7)%
Total	(1.7)%

3 Main Problems

- Housing Market
 - Imbalance in supply and demand.
 - Mortgage financing.
- Inflated Revenue Base
 - Revenues grew 38% in '05 and '06 compared to 19% personal income growth.
- “Wealth effect”
 - Declining housing values affect consumer psyche.

2 of 3 Real-Time Indicators Have Dropped This Fiscal Year

- Retail spending – down (1.2) %.
- Jobs – 41,500 jobs created
compared to 126,500 a year ago.
- Withholding – up 4%.

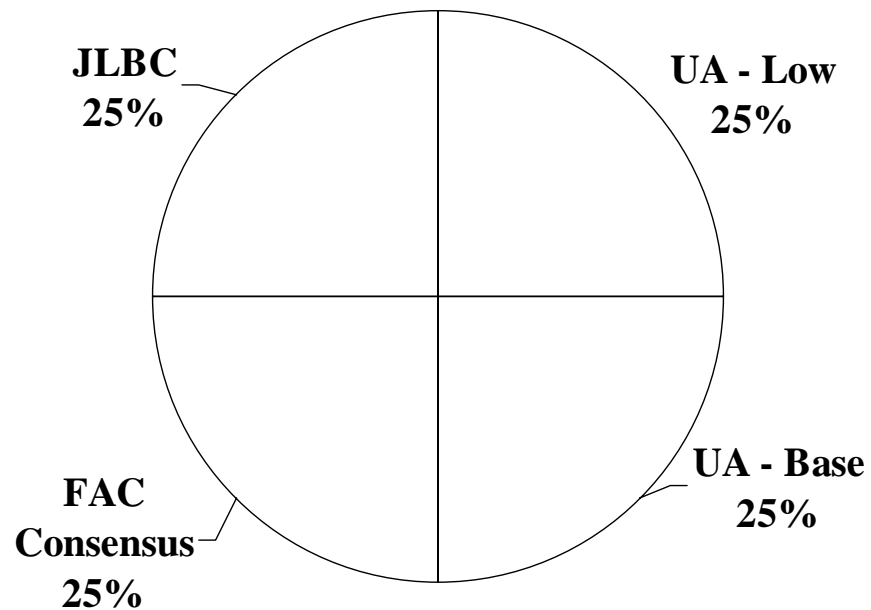
Overall Revenue Forecast

Where Are We Headed Over the Next Few Years?

- Four-Sector Consensus Forecast Incorporates Different Economic Views, Including the FAC

4-sector forecast equally weights:

- **FAC average**
- **UofA model - base**
- **UofA model - low**
- **JLBC Staff forecast**
- **Remaining revenues (4% of total) are staff forecast**



*** Includes Big 3 categories of sales tax, individual income and corporate income taxes.**

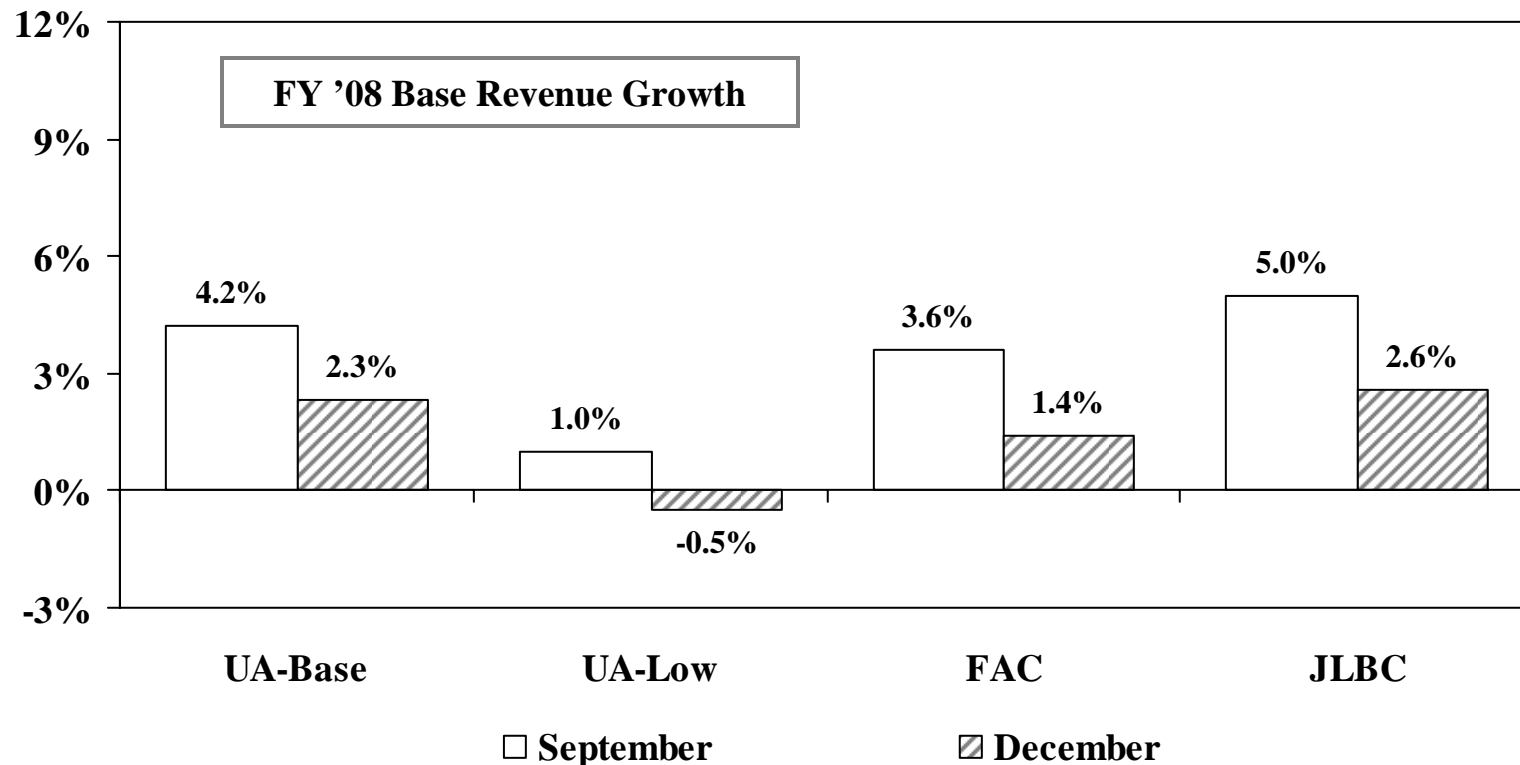
The Impact of Chapter 279

- The forecasts do not attempt to predict the effect of the new employer sanctions legislation.
- A disruption in labor supply could impact the state's economy – the magnitude is difficult to determine in advance.
- A decline in illegal immigrant use of public services could reduce government spending – again by a magnitude that is difficult to forecast.

New FY '08 4-Sector Growth Forecast is 1.5%

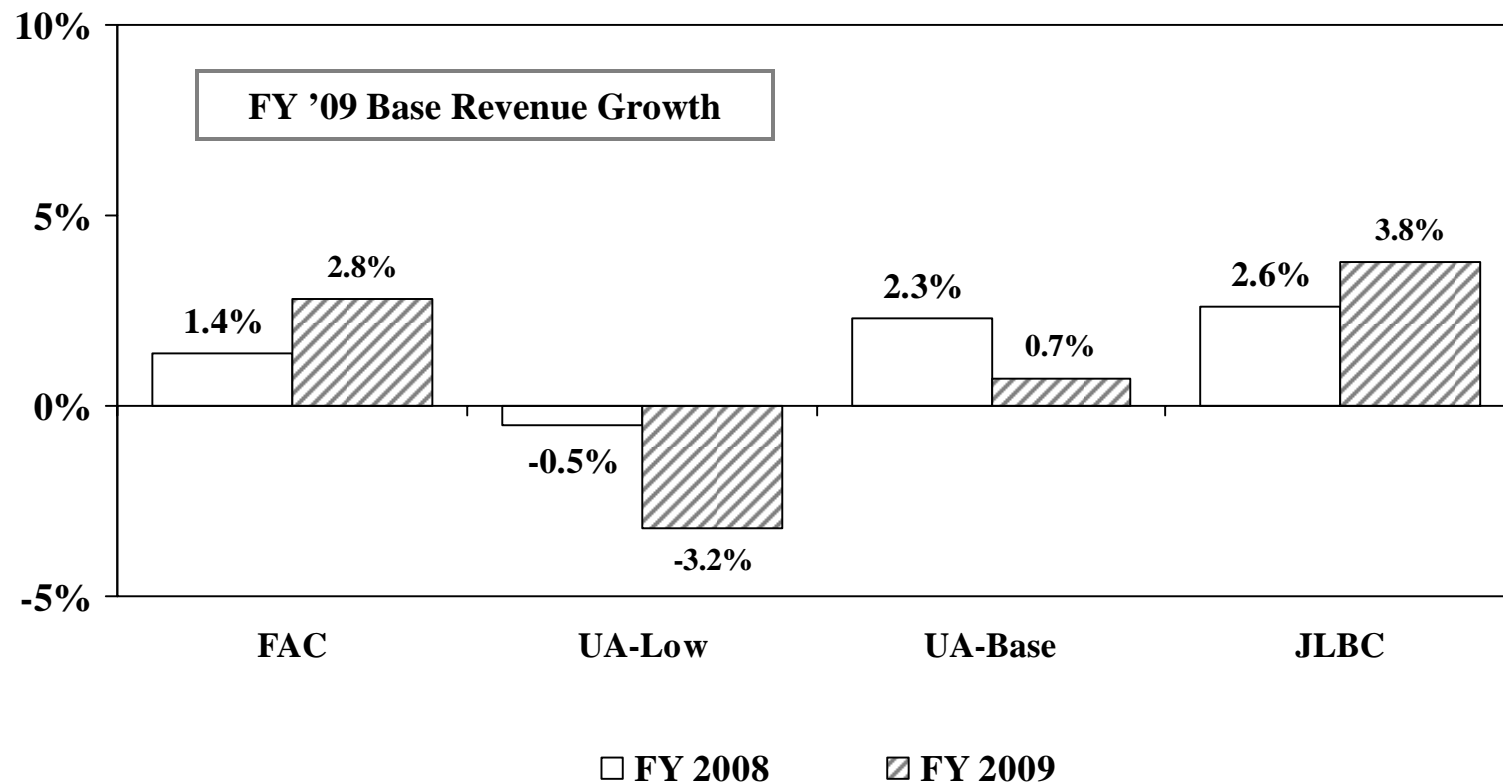
- Compares to a Budgeted Rate of 8.4%

- After Adjusting for Tax Reductions, the 4-Sector Rate is (1.1)%



**Weighted Big 3 Average
Prior to Tax Law Changes**

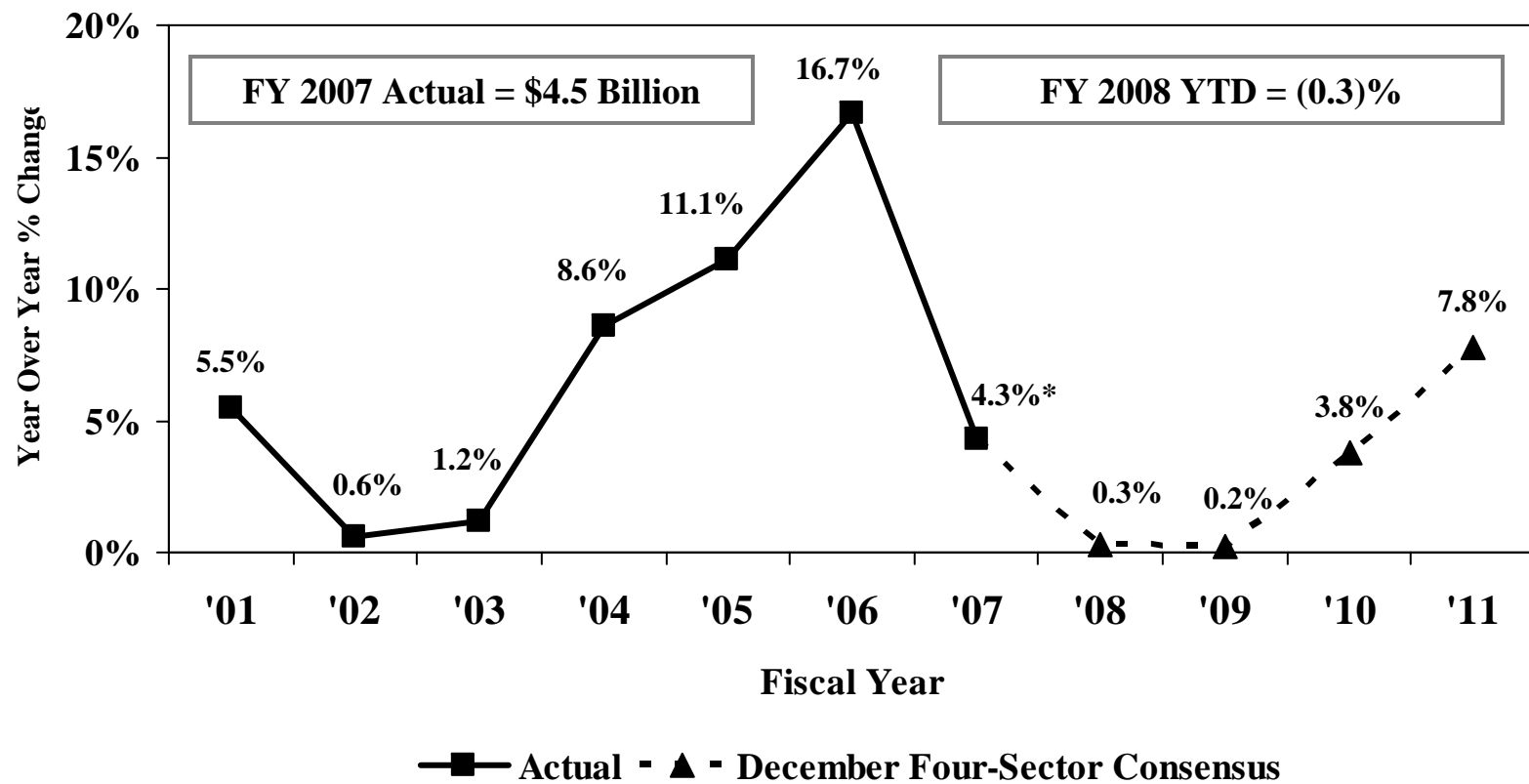
New FY '09 4-Sector Growth Drops from 1.5% in '08 to 1.0% in '09



**Weighted Big 3 Average
Prior to Tax Law Changes**

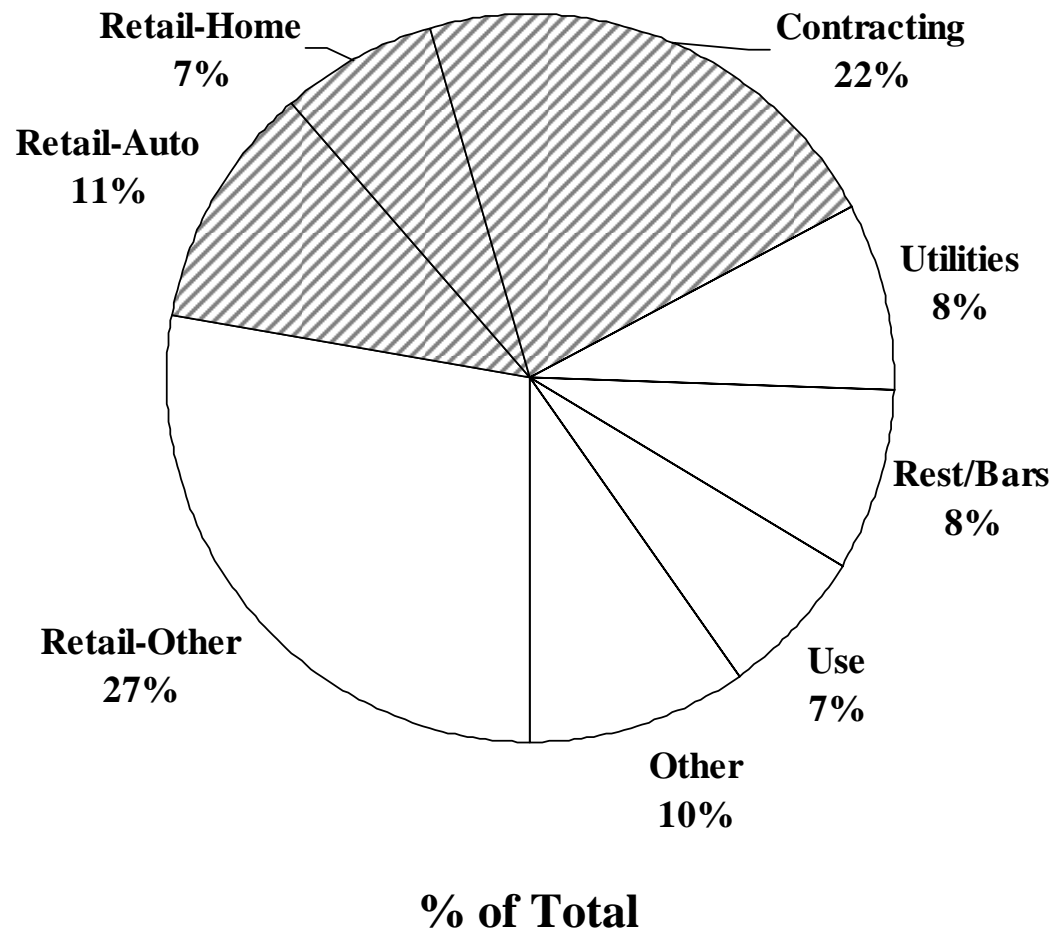
Revenue Forecast by Category

Sales Tax Growth Flat in '08 and '09

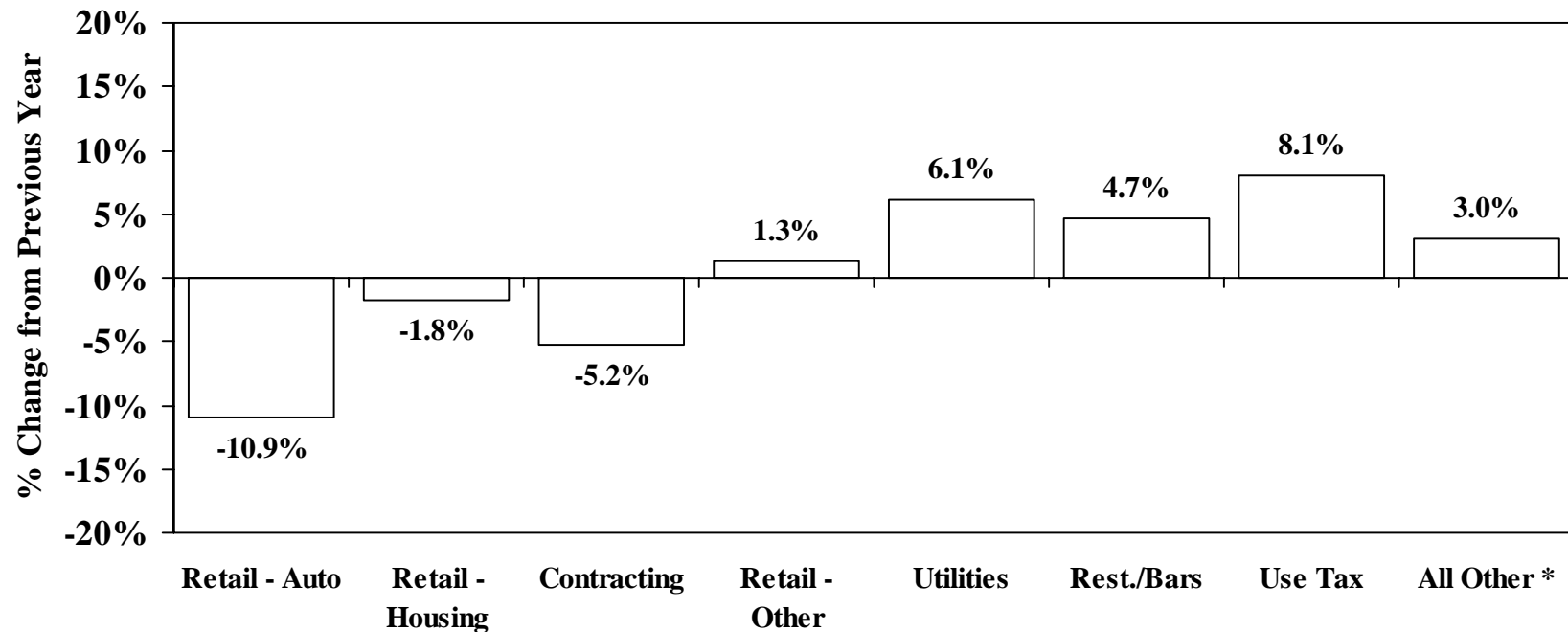


* 5.6% without the \$(55.2) million estimated payment threshold change.

Construction and Vehicles Constitute 40% of Sales Tax Collections



The Decline in Construction and Vehicle Spending Are Offsetting Gains Elsewhere



FY 2008 Year to Date – (Through September)

Falling Home Prices Affecting Consumer Spending

The “Wealth Affect”

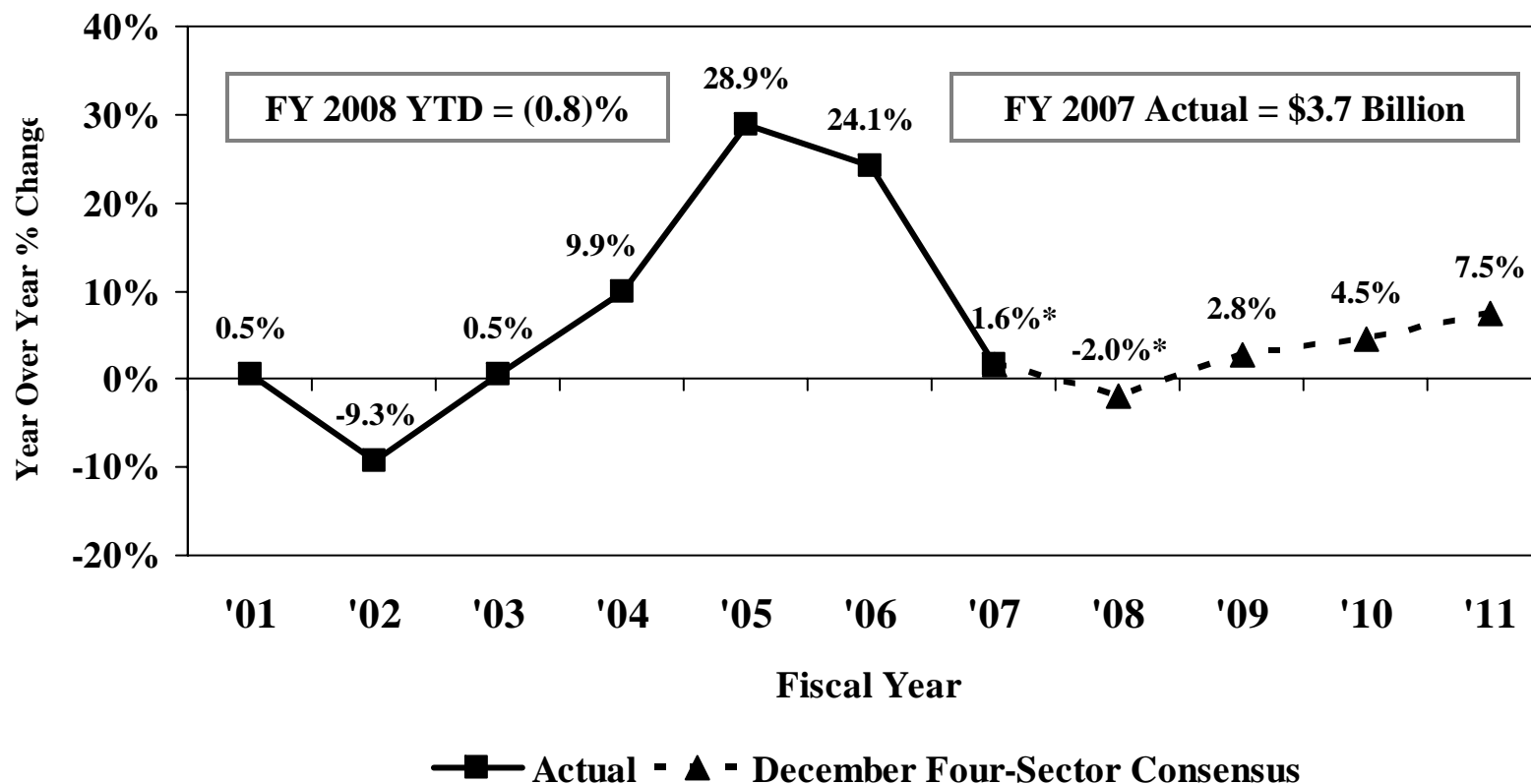
- Even if consumers are not selling their homes, declining housing values are thought to reduce their spending habits.
- National studies estimate that consumers reduce spending by 4-9¢ for every \$1 decline in house value.
- With a 10% decline in housing prices, Arizona sales tax would decline \$50 million, or (1)%.

Will Mortgage Proposals Help?

- For owner occupied homes, the Feds are proposing a 5 year rate freeze and refinancing assistance.
- Arizona has the 3rd highest rate of subprime loans, including 132,000 subprime ARMS.
- Feds' mortgage relief plan could affect an estimated 6,500 – 54,000 owner-occupied homes in the state.

Individual Income Tax Forecast

- Falls (2.0)% in '08 With A Slow '09 Recovery



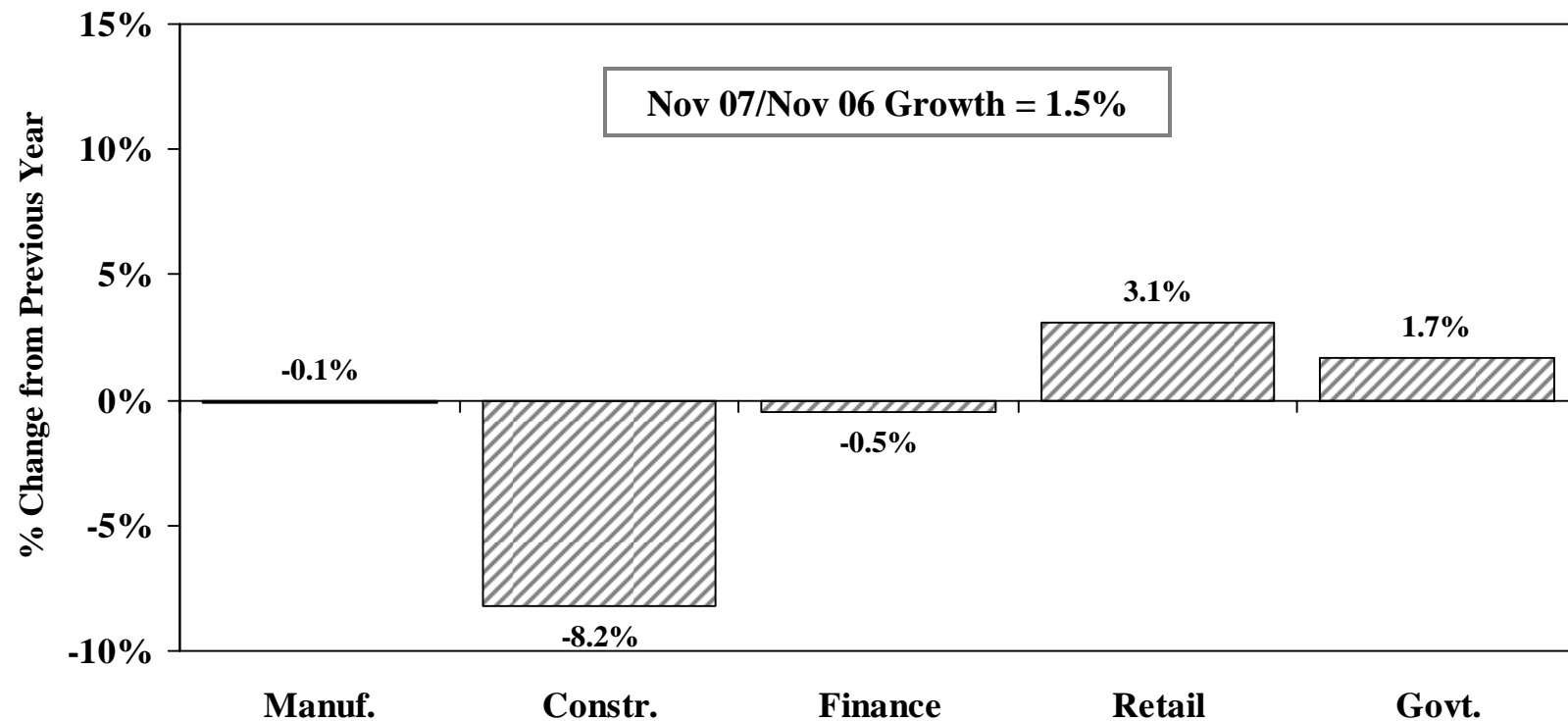
* Includes reduction for tax law changes.

Individual Income Tax 6-Month Collections Down (0.8)%

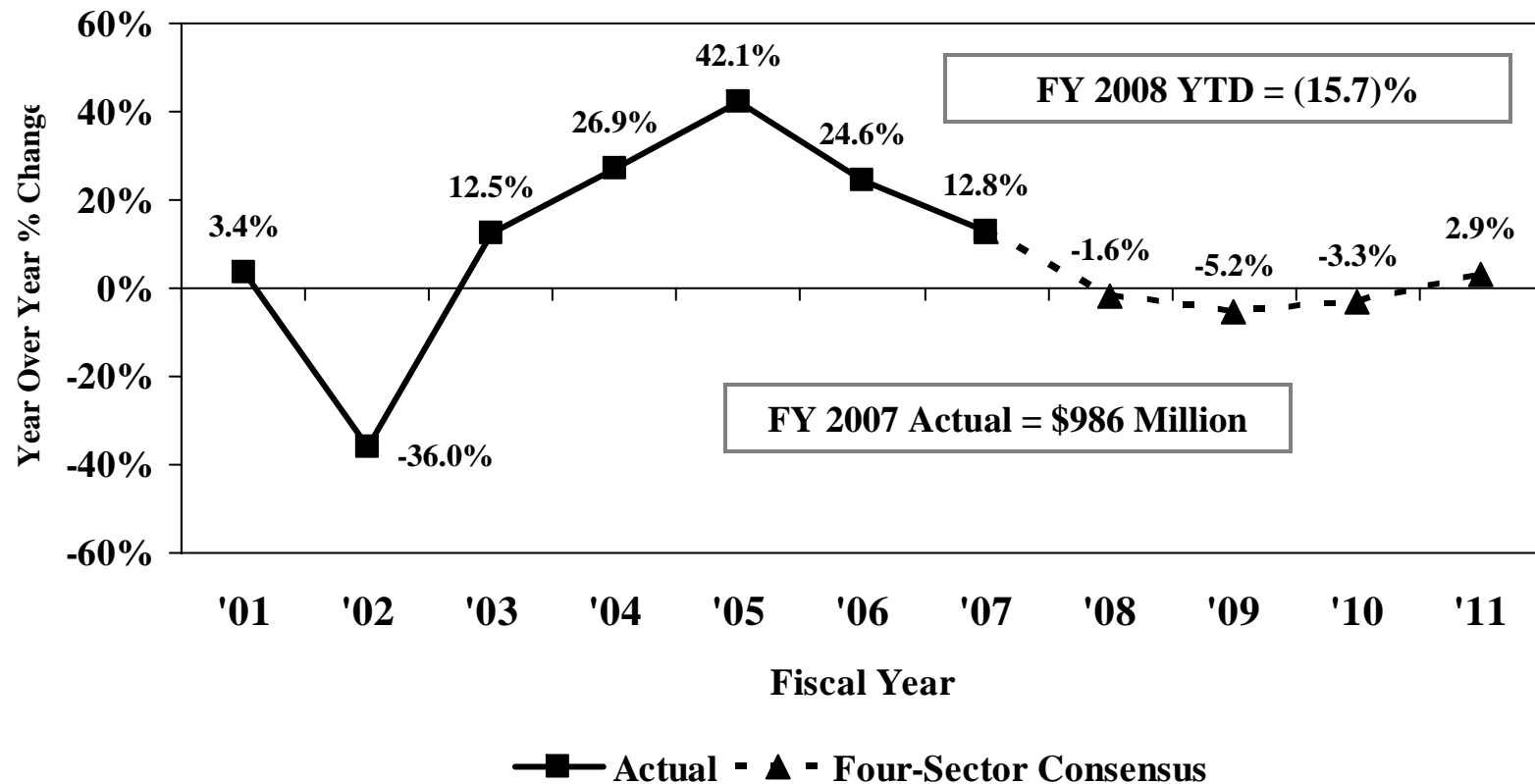
- Refunds have increased almost 22%
 - May be “hangover” effect – April extensions resulted in refunds paid out in October and November.
- Final payments are down (11)% YTD.
- Withholding has increased 4% through the first 6 months.

Job Losses May Moderate Further Withholding Growth

- Construction Sector Has Experienced Largest Job Loss



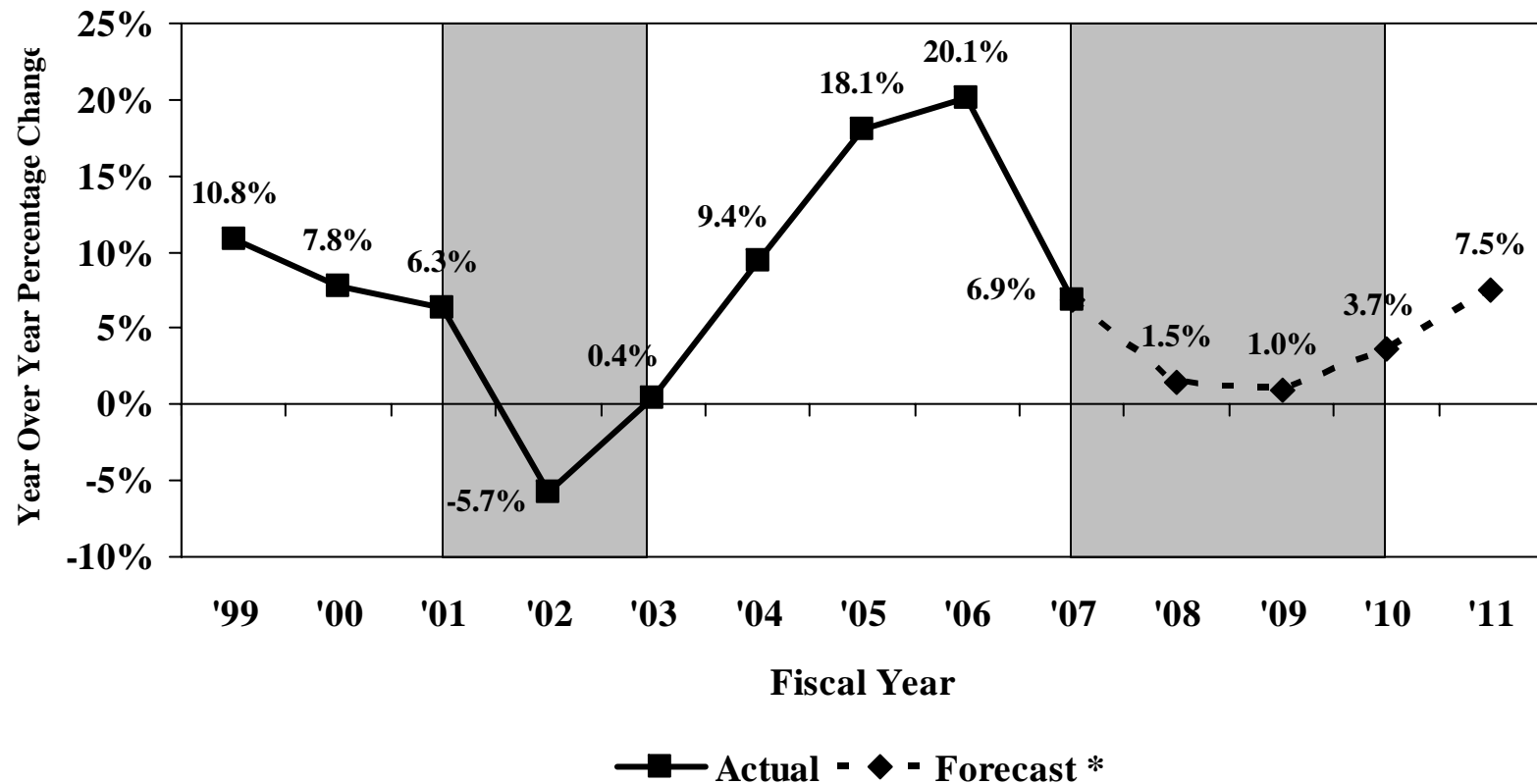
Corporate Income Tax Projected to Decline in Both FY '08 and FY '09



FY '08 – FY '11 forecast includes reduction for tax law changes.

Growth Remains Slow Until FY 2011

- September Forecast Had Similar “U” Shaped Curve



* 4-sector forecast weighted average growth.

Impact of 4-Sector Projections On Budget Shortfall

- FY '08 budget shortfall is projected to be \$970 million.
- If none of FY '08 solutions are on-going, FY '09 budget shortfall is \$1.7 billion.

FY 2008-FY 2011 Quartile Forecast Worksheet

	FY 2008	FY 2009	FY 2010	FY 2011
<u>Sales Tax</u>				
JLBC Forecast (11/07)	2.5%	3.0%	4.9%	6.7%
UA - Low (11/07 revision)	-1.9%	-4.3%	-0.1%	6.3%
UA - Base (11/07 revision)	-1.1%	-1.3%	3.7%	8.8%
FAC (12/10/07 Survey)	1.7%	3.5%	6.8%	9.4%
Average:	0.3%	0.2%	3.8%	7.8%
<u>Individual Income Tax</u>				
JLBC Forecast (11/07)	3.0%	4.8%	6.8%	7.8%
UA - Low (11/07 revision)	0.6%	-0.6%	0.3%	5.2%
UA - Base (11/07 revision)	5.8%	3.7%	3.9%	7.7%
FAC (12/10/07 Survey)	2.1%	3.1%	7.1%	9.2%
Average:	2.9%	2.8%	4.5%	7.5%
<u>Corporate Income Tax</u>				
JLBC Forecast (11/07)	1.9%	3.2%	2.2%	7.8%
UA - Low (11/07 revision)	1.6%	-8.5%	-5.5%	5.5%
UA - Base (11/07 revision)	4.9%	-2.3%	0.5%	2.7%
FAC (12/10/07 Survey)	-2.4%	-1.5%	2.2%	7.8%
Average:	1.5%	-2.3%	-0.2%	6.0%
Consensus Weighted Average:	1.5%	1.0%	3.7%	7.5%
JLBC Weighted Average:	2.6%	3.8%	5.4%	7.3%
UA Low Weighted Average:	-0.5%	-3.2%	-0.5%	5.8%
UA Base Weighted Average:	2.3%	0.7%	3.4%	7.7%
FAC Consensus Weighted Average:	1.4%	2.8%	6.5%	9.2%